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SMALL AND MEDIUM ENTERPRISE COMPETITIVENESS:  
INTERNATIONALIZATION STRATEGY

Internationalization Process of  $h_3$  to the US market

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## Executive Summary

Created in 2007,  $h_3$  is a Portuguese company that operates, mainly in Shopping Centres, in the fast food industry by offering cheap and unique “gourmet hamburgers” served on plates instead of bread.

In the beginning of 2011, the company started its international expansion programme by opening stores in Warsaw, Madrid and São Paulo, which were a great success; thus, the company wants to continue its internationalization to other markets.

As a result, this work project focused on the expansion of the  $h_3$  company to the US market, particularly to the New York State through a master franchising agreement. Although, this agreement will have some costs, these will be overcome by the advantages of having rapid expansion as well as an increase of brand awareness

**Keywords:**  $h_3$ , fast food, franchising, internationalization, New York.

## Business Description

The  $h_3$  – *hambúrguer gourmet* (abbreviated to “ $h_3$ ”), is a Portuguese company, created in 2007, that operates in the fast food industry, mainly in shopping centres, by offering cheap and unique “gourmet hamburgers”. These are made with 100% fresh and pure national beef and grilled with sea salt while eaten with cutlery and served on plates, instead of bread, with potatoes crisps or Thai rice on the side.

This new concept of “gourmet hamburgers” was denominated by “*New hamburgology*” and was considered as “*Not so fast food*” due to the fact that the food is served in a short period of time at a low cost but with quality and an excellent taste, instead of the usual fast food. Both terms mentioned were recently registered in the World Intellectual Property Organization (WIPO) and are company’s trademarks.

The  $h_3$  concept emerged in 2006 from a business that the three actual  $h_3$  partners’

(Albano Homem de Melo and António Cunha Araújo, who are lawyers, and Miguel Van Uden, who is a manager) had at that time, a restaurant called *Café 3*, which opened in 2004, at *Av. da Liberdade*, and offered gourmet food, with excellent quality, at higher prices. This restaurant was mainly attended during the lunch, by people who worked nearby and had greater purchasing power, thus, although *Café 3* was profitable, it was below partners' revenue expectations. Later, with the evolution of the restaurants' activity, the three partners faced a new trend; the majority of people who visited *Café 3* ate the "gourmet hamburger" menu.

Therefore, in 2006, the partners started to develop a new idea focused on selling only gourmet hamburgers, in shopping centres with no table service, to young business people who wanted to eat quality food at a low price. Additionally, since this new concept would offer only one type of product, the production would have to be time and cost efficient in order to compete with the other shopping centres' restaurants. Consequently, the partners standardized the employees' production processes by creating voluminous operating manuals that specified every store's operation aspect.

Furthermore, to offer high quality hamburgers, the three partners not only invited the *Café 3* meat supplier to become the  $h_3$ 's hamburger supplier but also appointed, due to his know-how and experience, the *Café 3 Chef*, Vítor Lourenço, to become responsible for the "Escola de Grelha". Later on, both the meat supplier and the *Chef* became key partners and, in 2007, the  $h_3$  partners launched two own  $h_3$  stores in Shopping centres, due to the learning experience and the industry know-how acquired through *Café 3*, which was closed afterwards due to the impossibility of conciliating both businesses.

Moreover, the  $h_3$  partners focused on every detail of the branding (Exhibit 1) and invested a lot on internal marketing, in order to have satisfied and happier employees.

This was possible due to partners' creativity and due to the company's flat and informal organization structure, which eased the communication flow within the firm (Exhibit 2). Since the beginning, these restaurants had a great acceptance because of customers' perception of  $h_3$  as a "healthier food" with a better quality/price ratio, which was something that people started to search more in Portugal (Euromonitor International, 2011a). However,  $h_3$  was unable to explore all the country's market opportunities due to lack of capacity; therefore, the company started to think on a franchising model that would help the company's domestic and international expansion. As a result, in 2008, the first franchisee became responsible for expanding  $h_3$  throughout the regions situated upon Coimbra, and, in 2010, another franchisee become responsible for any store opened in Madeira and Azores. Consequently, both franchisees are considered  $h_3$  key partners, and, at the present moment, the first franchisee is responsible for ten stores, in the north, and the second one is in charge of two stores, one in each archipelago. Additionally, in 2011,  $h_3$  started its international expansion by opening four new foreign restaurants; one in Warsaw and two in São Paulo, through Joint-Ventures, with Portuguese partners to create brand awareness abroad, and another in Madrid, where "Grupo VIPS" is the franchisee responsible of opening  $h_3$  stores in Spain and Andorra. Hence, the  $h_3$ 's evolution, since 2007, was the following:

**Table I –  $h_3$  number of stores, employees and business volume over the years**

Year	Number of stores in Portugal		Number of foreign stores	Total number of stores	Total number of employees	Business Volume (in thousand €)
	Own stores	Franchising				
2007	2	-	-	2	40	341
2008	6	2	-	8	140	3,027
2009	17	4	-	21	400	10,987
2010	22	11	-	33	600	22,000
2011	27	12	4	43	700	n.a.

(Source:  $h_3$ , 2011)

According to **Table - I**,  $h_3$  faced a huge expansion, thus, in order to easier monitor and

control the production chain procedures,  $h_3$  decided to have only one supplier for all products, the Distribution Centre, which is also a key partner.

### Mission, Vision and Strategic Objectives

Regarding  $h_3$ 's mission, the company aims to serve a meal of excellent taste at a low cost in a short period of time.

Concerning  $h_3$ 's vision, the company aims to be the best hamburger chain in the world.

Therefore, the firm is planning to be present in all continents within 5 years.

The strategic objectives of the  $h_3$  company vary according to the market in question:

**Table II –  $h_3$  Strategic Objectives for 2012**

Domestic Market	Foreign Market	Global Market
<b>Open:</b> - 4 to 5 stores in Lisbon - 4 to 5 stores in Oporto - 1 street store in Oporto	<b>Open:</b> - 10 stores in Madrid - 3 to 4 stores in Poland - 2 to 4 stores in São Paulo	- Achieve a sales volume of €40 million - Decrease operational losses by 10%-15% - Increase brand awareness by: - rising “word of mouth”; - giving invitations for free meals; - having “opinion makers” writing on magazines.

(Source:  $h_3$ , 2011)

### Purpose of the Work and Methodology

The aim of this work project is to do an Internationalization Plan for the  $h_3$  company.

Hence, in order to perform the Internationalization Plan, first, the domestic market was analysed by a group, composed by five students, and second the US market, one of the foreign markets to where the company wants to expand, was analysed individually.

Regarding the analysis of the domestic market, the main purpose was to analyse the Portuguese fast food industry as well as the  $h_3$  company (more precisely the Shopping centres' stores) in order to define the market and the company's competitiveness.

Hence, to start the group had interviews with the  $h_3$ 's partners in order to fully understand the company's whole business; subsequently, the group had access, through

*Euromonitor International*, to a variety of reports, which helped to understand the company's positing in the fast food industry, however, since the competitors and the substitutes of the company were not well defined, the group opted to perform an online and in stores survey, to  $h_3$  consumes, to define both competitors and substitutes; and, finally, the group also used web sites to search for Portuguese market trends.

Concerning the foreign market,  $h_3$  desires to continue its international expansion through five different countries, more precisely, United States of America (US), Brazil, United Kingdom, Germany and France. As a result,  $h_3$  recommended each one of the group members to study a specific country. In detail,  $h_3$  charged me of individually study the US market, however, since it is a huge and very diversified country and since there was lack of time, this study focused the New York State, more precisely the New York City, which is the city that has more open minded people, therefore it is where  $h_3$  has more possibilities of being well accepted.

In order to perform the foreign analysis, since there was no specific information about the New York State, except New York suppliers' bargaining power, the market analysis and the Porter's Five Forces, which are expected to apply to the New York State, were performed for the US as a whole, however it is important to take into consideration the possibility of existing biases. To find the necessary information different web sites, *Datamonitor* reports and books recommended by the advisors were used.

Additionally, to accomplish the whole study, the weekly meetings and the workshops headed by the advisors were attended.

### **Industry Mapping (Exhibit 3)**

$h_3$  faced a huge expansion and developed close relations with many different entities.

**Distribution Centre:** The  $h_3$  company has a unique direct supplier, the Distribution

Centre, which is in charge of many indirect suppliers (Exhibit 4).

Regarding the direct supplier, it is a key partner and it has a specific contract with  $h_3$ , which states that the Distribution Centre is in charge of purchasing, storing and delivering the final products to all  $h_3$  Portuguese stores even if franchised or owned by the  $h_3$ 's partners. These final products are only delivered after each store send its own products' request to the Distribution Centre and  $h_3$  *headquarters*, which are responsible for controlling the quantities demanded. In addition, the Distribution Centre is in charge of managing the stocks and verifying the products quality.

As a result, the Centre of Distribution has the advantage of selling a large amount of products, with a considerable margin, and  $h_3$  has the advantage of not having storage and stock management costs, because it does not have any products to store.

In order to have information about foreign stores' suppliers see Exhibit 5.

**Shopping Centres:** The majority of  $h_3$  stores are present on Shopping centres; thus,  $h_3$  pays Shopping malls' rents and it also obeys to each Shopping mall's rules.

**Market Regulators:** To open a restaurant is necessary to obtain a license from the Municipal Council; afterwards, the restaurant will be supervised by an entity, named "Autoridade da Segurança Alimentar e Económica" (ASAE), that will verify if all the existing legislations are being followed.

**External Auditors:** When the products are already inserted in the production chain of  $h_3$  (Exhibit 6), the company requests the services of two external auditors: "Controlvet", which is in charge of ensuring food safety by controlling the quality of the products and the hygiene of the processes, hence, it audits the warehouse, the transports and the stores, and it is also responsible of doing pest control to all the process intervenients; and, "Cliente Mistério", which is a firm that substitutes customers direct feedback.



Thus, it gives feedback of  $h_3$ 's service provision, as if it was a normal client.

However, when  $h_3$  wants to implement a new product, in any store, the  $h_3$  Quality Department is the first auditor (Exhibit 7).

**Competitors:** In the foodservice industry  $h_3$  has a broad range of direct and indirect competitors. The direct competitors, the ones that we are going to focus on, correspond to restaurants that are placed in the same location of  $h_3$ , food courts of Shopping centres, and have both quick service and similar price. Regarding the indirect competitors, these correspond to all the other restaurants available in the foodservice industry.

As a result, in order to find  $h_3$ 's competitors the group have done online and food court surveys to  $h_3$  consumers and have concluded that the main  $h_3$  direct competitors were the following companies: McDonalds, Vitaminas & Companhia, Noori Sushi, Go Natural, Pans & Company and Joshua's Shoarma (Exhibit 8).

**Substitutes:** Substitute products correspond to products that may replace each other as a result of changing conditions; thus,  $h_3$ 's substitutes are homemade meals, which could be ready meals or ingredients for home cooking.

**Franchised stores, Own stores and Final customers:**  $h_3$  has two types of business approaches, business to business and business to consumer.

Concerning the franchised stores, these follow a business to business approach, since it is a transaction between two businesses, the  $h_3$  and the franchised store. Additionally, the  $h_3$  own stores and the final customers (who consume a  $h_3$  meal, either on franchised or owned stores) follow a business to consumer transaction, as a result, through this approach the  $h_3$  *headquarters* have the whole information available, since the moment that the Distribution Centre delivers the raw materials to the stores until the moment that the final product is delivered to the final consumer.

**Partners:**  $h_3$  has four key partners which helped on the company's expansion, they are:

- The *Chef*, Vítor Lourenço, is a minority shareholder and an experienced professional who had an important role in  $h_3$ 's development. First, Vítor is responsible for the “Escola de Grelha” that is in charge of forming the workers who are going to grill the hamburgers. Second, he is also in charge of the “opening team” which is a high performance team that is responsible for working at new stores opening. And third, the *Chef* was responsible of adapting the hamburger's family recipes to mass production recipes, which had to be equal in all stores
- The franchisees are also key partners and had an important role on the company's growth. In fact, the franchisee responsible for opening stores through the north of the country helped on  $h_3$ 's expansion due to his fast food market knowledge, since he was already the “Vitaminas & Companhia” franchisee, in Oporto.
- The meat supplier accompanied the  $h_3$  growth by opening a new factory that would only supply hamburgers to the  $h_3$  stores, thus he became a key partner.
- The Distribution Centre, mentioned above, is also a key partner due to its huge responsibility of providing all the ingredients to every  $h_3$  store (own and franchised).

### **Own stores Value Chain (Exhibit 9)**

The following Value Chain corresponds to the chain of activities, primary and secondary, performed by the  $h_3$ 's own stores, in the fast food industry; as well as the costs of the  $h_3$  *headquarters*. Therefore, this analysis does not take into account the franchisees revenues, due to lack of information.

Regarding the primary activities, which are divided into Assembling Line and Marketing/Sales/Service, these represent 31% and 5% of the company's total costs, respectively. The former costs correspond to the store's cost of assembling a final meal,

which include: food preparation; cleaning, repair and maintenance of stores; wastes; and, worker's salaries, which represent one of the company's major costs. Thus, in order to diminish the Assembling Line costs,  $h_3$  pretends to reduce the costs with workers, by reallocating the existing workers to new stores, and to diminish the wastes. Regarding the latter costs, these correspond to the company's small expenditure on marketing and publicity, since  $h_3$  bets on word of mouth publicity.

The secondary activities are divided into three main areas, which are the following:

Firm infrastructure - Correspond to costs with management, consulting, audit, quality, as well as, costs related with legal and financial issues. Thus, these costs represent 25% of the total costs of the company.

Human Resources Management/Technology Development – Represent 3% of  $h_3$ 's total costs. Here are included the office's workers salaries and technology development costs since some workers' salaries include costs with product development.

Procurement – Represents 34% of the  $h_3$  total costs, in detail, it includes the Distribution Centre costs, stores and offices rents, as well as, rents of other materials.

To conclude, the margin of  $h_3$  is 4%, which can be underestimated since this Value Chain only considers own stores' revenues and costs of both own stores and office.

### **Competitive Advantages**

There are some factors that are essential for any company sustainability such as strong brand recognition, key partners, process standardization and market know-how, which is something that  $h_3$  has, (Exhibit 10) and other factors that correspond to company's competitive advantages. In detail, one competitive advantage of  $h_3$  is the option that people have to create their own meal, more precisely; first, people choose the menu, second, choose a well or medium beef, third, decide what they want for trimming (only

potatoes, only rice or both) and forth, choose between a wide variety of side dishes.

Moreover,  $h_3$  offers hamburgers on plates, which are perceived as homemade meals, thus, this is another competitive advantage since homemade meals are supposed neither to belong to the mass-market nor to be served in short periods of time.

### **Fast Food Market Definition**

In order to analyse the fast food industry, first it is necessary to define the market in question. Therefore, the fast food market is described as the sale of food and drinks for instant consumption, either on the site or in designated eating areas shared with other foodservice operators, or even for consumption in a different place. This market is valued according to the Operator Buying Prices (OBPs), which corresponds to the amount spent by foodservice operators on the food and drinks that they supply, and the market volume is classified as the total number of visits, by individuals, to foodservice locations that involve food and/or drink's consumption.

Additionally, the fast food market is divided into four segments. More precisely, the Quick Service Restaurants (QSR), which mainly provide full meals, with no table service; the Takeaways, where, typically, more than 80% of the revenues come from food consumption off the sites; the Mobile & Street Vendors, which are individual mobile vans that offer prepared food; and, the Leisure Locations that offer products for immediate consumption on premises within leisure outlets (Datamonitor, 2010b).

### **Fast Food in Portugal**

#### **Portugal Fast Food Market Analysis**

“Portuguese consumer foodservice sales in 2010 were negatively impacted by the economic downturn” (Euromonitor International, 2011a:1). Therefore, in 2010, the performance of the consumer foodservice market was negative due to decreases on total

value of sales (-2.4%) and total number of transactions (-2.7%), to €8.1 billion at current prices, and to 1,580 million, respectively. However, regarding the fast food market, “in terms of all consumer foodservice sales, it performed the best in 2010” (Euromonitor International, 2011b:1), increasing by 3% in both value terms and number of transactions, reaching a market value of €715 million and a number of transactions of 139 million, which was possible mainly due to consumers downgrading demand from full-service restaurants to fast food restaurants and home delivery/take away.

Additionally, due to the economic downturn, the consumer’s price sensitivity increased, thus the majority restaurants started to practice discounts in order to attract customers.

Furthermore, Portuguese consumers became more conscious and paid more attention to the food that they eat, which increased the demand for healthier meals.

Finally, since consumers changed from conventional restaurants to fast food restaurants, the market assisted to both the expansion of the existing chains across the country and the emergence of cheaper and healthier chains such as *h<sub>3</sub>*, *Bom Bocado* and *Jeronymo*.

Regarding *h<sub>3</sub>*, the company took advantage of the market opportunity by offering cheap and healthier meals, and, in 2010, only three years after opening the first store, achieved a 4.9% market share in the fast food industry and a 3.2% market share, which is the same market share of *Burger King*, in the Portuguese foodservice (Exhibit 11). As a result, *h<sub>3</sub>*, in Portugal, is the fifth company with the highest market share in the fast food and the seventh in the consumer foodservice (Euromonitor International, 2011b).

### *h<sub>3</sub>* Porter’s Five Forces

**Barriers to entry** – Nowadays, the fast food industry is at the mature stage (Roman Zwolak, 2010) of the Industry Life Cycle (Exhibit 12). Additionally, there is a wide range of restaurants, with different products, available into this market and the access to

distribution channels (Shopping centres) is difficult; therefore, accordingly to these factors, the barriers to entry are considered high. Moreover, to start a business into this market it is necessary a substantial capital investment, around 200,000€, which compared to other industries is not that much; however, due to the financial situation of the country, this investment can be difficult because of the current high interests rates and the possibility of not getting the loan. Additionally, to start a business it is also necessary to be cost efficient, since the majority of the fast food companies compete on price, and build a new and recognized brand; thus, accordingly to these factors, the barriers to entry are considered high, as well.

Above were stated the major barriers to entry, yet, there is one advantage of entering into this market, the low switching costs; consequently, if people perceive the restaurant as good it will attract new customers easily. Thus, the barriers to entry are medium/high.

**Threats of substitution**– The substitutes of the  $h_3$  company are, mainly, homemade meals. More precisely, ready meals and ingredients for home cooking. In brief, since Portugal is facing an Economic Crisis, the number of people opting for consuming their own cooked meal is increasing. As a result, the threats of substitution are moderate.

**Buyers' bargaining power** – The  $h_3$ 's consumers are mainly people that, even though being price sensitive, have lower sensitivity to price and consequently have low bargaining power. This is explained by the fact that people choose  $h_3$ , which is a bit more expensive than the majority of the other fast food meals, even knowing that there is a wide variety of competitive products available and there are low switching costs; thus, due to these factors, buyers bargaining power is low.

However, usually substitute products (homemade meals) are available; therefore, regarding this reason, the buyers bargaining power is moderate.

Thus, since the first factors outweigh the last one, the buyers bargaining power is low.

**Suppliers' bargaining power** – The  $h_3$  company has only one direct supplier, the Centre of Distribution, which is supplied by several indirect suppliers that are essential players in the production process of the  $h_3$  company.

Concerning the Centre of Distribution,  $h_3$  is highly dependent on it due to the fact that it purchases, stores and distributes all the  $h_3$  products; hence, if the contract is finished  $h_3$  faces high switching costs since it has to find, in a short period of time, another Distributor to all the products. Thus, the Distribution Centre's bargaining power is high.

Regarding the bargaining power of indirect suppliers see Exhibit 13.

**Competitive rivalry** – The main competitors of  $h_3$  are restaurants that offer quick meals at a low price, mainly in Shopping centres. Some examples are: *McDonald's*, *Vitaminas & Companhia* and *Go Natural*. As a result,  $h_3$  has numerous competitors, with strong reputation, and, since the switching costs are low, the competitive rivalry is high. However, the majority of the products available, in the fast food market, are well differentiated; as a result, the competitive rivalry is low.

Thus, the competitive rivalry is high, since the fact that there are many competitors and low switching costs outweighs the fact that there are many different products available.

### **TOWS Analysis**

In order to perform the TOWS analysis of the  $h_3$  company, the group have previously done the SWOT analysis (Exhibit 14).

#### **Strategies that use Strengths to maximize Opportunities**

$h_3$  created two trademarks “*New hamburgology*” and “*Not so fast food*” to denominate the new concept of “gourmet hamburgers”, these are cooked with fresh and quality ingredients, and are perceived, by consumers, as “healthy food”, hence, the company is

taking advantage of an opportunity, the demand increasing of healthy products. Besides, these quality products are sold at affordable prices, in other words,  $h_3$  offers a good price/quality relationship, something that people look for when dealing with an Economic Crisis, thus the company is also taking advantage of this opportunity.

Additionally,  $h_3$  has a broad market experience due to its advanced stage on the Learning curve, therefore, the production and distribution processes are all standardized, which is a company's strength; consequently, it will be easy to apply the  $h_3$ 's business model to a franchising model; the most common model of the fast food industry.

Another opportunity of the market is the increase of the fast food consumption, due to customers trading down; therefore, the company used two of its strengths, key partners and employees training programs, to take advantage of this opportunity. More precisely, the key partners were able to follow the company's growth, and the training programs allowed the company to be more cost and time efficient, one of the most important characteristics of the fast food market.

Finally,  $h_3$  has the benefit of having a well-known and recognized brand in Portugal, thus the company has easier access to Shopping centres, which are increasing in Portugal (AICEP Portugal, 2010), as a result, the company should continue to position on Shopping centres to take advantage of this opportunity.

### **Strategies that use Strengths to minimize Threats**

$h_3$  offers a mono-product, which is a strength since it allows the company to be more cost and time efficient due to company's standardization of processes; thus,  $h_3$  could easily compete with the wide range of restaurants available in the fast food industry by offering take away meals, which are a new and increasing trend in Europe and Portugal (Euromonitor International, 2011a); thus,  $h_3$  would be able to minimize this threat.



Moreover, the majority of  $h_3$ 's competitors have strong brand recognition, which is a threat for the company in both national and international markets. Therefore, to minimize this threat  $h_3$  cannot neglect the task of investing on branding.

#### **Strategies that minimize Weaknesses by taking advantage of Opportunities**

One weakness of  $h_3$  is the non appealing Shopping centre environment, despite this reason, it is a fact that Shopping centres benefit from large influxes of people during the day. In addition, the number of Shopping centres in Portugal is increasing; therefore, the company should take advantage of this opportunity by continuing to position, mainly, in Shopping centres.

Furthermore, the corporate team members are really close to each other; consequently, sometimes they do not formalize all the company tactics and strategies. Therefore, in order to reduce this risk, the company should invest on a business format franchising.

#### **Strategies that minimize Weaknesses by avoiding Threats**

One weakness of the company is the lack of market research; therefore, in order to avoid possible threats,  $h_3$  should increase its market research.

Additionally,  $h_3$  offers only one type of meat; hence, it faces a threat if there is another “cow disease” or similar epidemic. Thus,  $h_3$  could start to produce other types of hamburgers that fit into the  $h_3$ 's concept, for example, soya or vegetarian hamburgers.

### **Internationalization Strategy**

#### **US Fast Food Market Analysis**

In 2007, the US fast food market enjoyed a strong growth (6.1%) due to the elevated consumer confidence; however, in 2009, the market suffered a decelerating growth of 0.2%, reaching a value of \$71.4 billion of total revenue. Additionally, the compound annual growth rate in the period 2005-2009 (CAGR<sub>(2005-2009)</sub>) was 3.7%.

For the upcoming years, the market value is forecasted to increase, having a predicted value of \$77.5 billion, in 2014, and a CAGR<sub>(2009-2014)</sub> of 1.7%.

Regarding the market consumption volumes in 2009, the US fast food market grew by 0.9%, reaching a volume of \$40.3 billion of transactions and a CAGR<sub>(2005-2009)</sub> of 2.8%.

During the following years, the market's volume is also forecasted to increase, reaching a volume of 42.9 billion of transactions, in 2014, and a CAGR<sub>(2009-2014)</sub> of 1.2%.

Moreover, in 2009, the QSR segment was the most profitable of the fast food market, with \$59.7 billion of total revenue, corresponding to 83.5% of market's overall value.

To conclude, in 2009, the US fast food market accounted for 35.5% of the global fast food market value, and the remaining percentage, 64.5%, corresponded to Asia-Pacific (35.6%), Europe (17.0%) and the Rest of the World (11.9%) (Datamonitor, 2010a).

### US Porter's Five Forces

**Barriers to entry** – “Entry to the US fast food market does not require large capital outlay” (Datamonitor, 2010a: 14). This can be explained by the fact that opening a single, independent fast food restaurant is within the possibilities of many individuals in the US and, since the switching costs of the fast food market are low, consumers can easily change their habits and go to new restaurants. Thus, barriers to entry are low.

However, there are some barriers that market entrants face; price retaliation by existing players and, low market attractiveness mainly due to weak revenue growth rates during the last years.

Hence, the US and the New York barriers to entry are moderate (Datamonitor, 2010a).

**Threats of substitution** – Fast food substitutes consist, mainly, on ready meals and ingredients for home cooking, as mentioned previously.

In order to analyze the threats of substitution it is important to understand that people

eat fast food due to its value and, mostly, due to its convenience and availability. Therefore, since fast food substitutes are convenient and have low value, the threats of substitution are high; however, since home cooking is time consuming and it is difficult to manage with working far from home, which usually is the case in New York, the threats of substitution are considered low.

Additionally, since the demand of healthy products is increasing, fast food restaurants are starting to offer healthy products and to write the calorie-content of the products on the menus, according to the America's health reform bill, in order to diminish the threats of substitution.

Thus, in the US the threats of substitution are considered moderate (Datamonitor, 2010a) and in New York the threats of substitution are also considered moderate.

**Buyers' bargaining power** – The main source of buyer power are the low switching costs, since within a given price range, the consumer's preference depends only on personal taste. According to this reason, buyer's bargaining power is high. Additionally, the economic crisis also strengthens the buyer's power due to the competitive pricing strategies that food service operators perform, in order to secure price sensitive consumers and raise revenues.

However, since consumers only buy one meal, which usually has a small impact on the company's revenue; and, since companies invest on brand awareness, which increases customer's loyalty and decreases buyer's power, the buyers bargaining power is low.

Consequently, taking into account all the factors, the US buyers bargaining power is medium (Datamonitor, 2010a) and the same applies for the New York buyers.

**Suppliers' bargaining power** – Within the fast food market it is important to preserve a reliable food supplier that efficiently provides quality food in a generally "low margin/

high volume business”, which allows a company to keep the food costs down.

In the entire US, the supplier market is quite consolidated due to the fact that just two supply companies have significant market shares (Sysco Corporation, 17% and US Food Inc, 8.6%<sup>1</sup>) and these are not dependent on fast food companies, since they also have consumers on other segments, as a result, they have strong supplier power (Datamonitor, 2010a). However, considering companies operating in regional areas, more precisely, in the New York state, there are other firms that also compete with the two companies mentioned before, such as Maines Paper & Food, Golden State Foods Corporation and Keystone Foods LCC, therefore, the New York’s supplier market has more competition and has moderate supplier power (GlobalData, 2009).

Thus, considering the entire US, the suppliers’ bargaining power is strong; however, considering only the New York state, the suppliers’ bargaining power is moderate.

**Competitive rivalry** – “the (*fast food*) market as a whole is fairly fragmented, with many independents as well as larger chains” (Datamonitor, 2010a: 15), therefore the competitive rivalry of the whole market is high. Additionally, the majority of the fast food restaurants focus on “low margin/ high volume business” in order to maintain profitability, and on brand power that is one of the greatest forms of competition; thus, these factors also justify the great competitive rivalry of the market.

Nevertheless, the competitive rivalry of the fast food market in the US is assessed to be strong (Datamonitor, 2010a) and the same applies to the New York state.

### **New Yorkers’ attitudes and habits**

In order to open a restaurant in the US, more precisely in New York City, it is important to understand New Yorkers’ attitudes and eating habits.

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<sup>1</sup> [http://www.wikinvest.com/stock/Sysco\\_\(SYN\)](http://www.wikinvest.com/stock/Sysco_(SYN)) (accessed November 15, 2011)

To start, the New York City is the largest and the most populous US city, with more than 8 million people, accounting for about 40% of the New York state population (Population Division U.S. Census Bureau, 2009), who share eating habits and traditions. Nowadays, American meals, like New Yorker meals, consist mainly on burgers, pizzas, hot dogs and sandwiches coupled with soft drinks. Moreover, New Yorkers prefer fast food restaurants to homemade meals, mainly because not only these are quick, cheap and tasty, but also because they do not have time to cook a full meal due to their business work schedules (USTCi).

Regarding the lunch, New York's employees tend to have, at most, one hour for lunch, therefore, they usually eat in the office at their desks. According to Manuel Moniz, a Portuguese living in New York since 2007, "New Yorkers tend to do one of the following three things; bring their lunches from home, which are mainly cold meals, such as sandwiches, go to a fast food restaurant and ask for take away to eat at the office, or even, call for restaurants that have home/office delivery, which correspond to the majority of the restaurants, and pay a tip of 15% to 20% to the delivery man, in order to eat at the office, as well".

Concerning the dinner, usually New Yorkers have dinner at home, however since they prefer fast food restaurants to homemade meals, they frequently order their dinners from restaurants that have home delivery. Otherwise, if they have dinner out of home they tend to go to fancier and more expensive restaurants (Susan Schneider).

Regarding Shopping centres with food courts, these almost do not exist in New York City, since the majority of New Yorkers prefer to eat on street restaurants while moving from one place to another instead on food courts.

### **Mode of entry**

## Franchising

In order to open new stores around the world,  $h_3$  needs to define the way that the company should internationalize. Hence, after analysing the main characteristics and advantages of franchising (see Exhibit 16 for more detail) the company should focus on a business format franchising agreement, where the franchise would use the company's complete method of doing business, and on a multi-unit franchisee, more precisely, a master franchisor that would be in charge of opening and sub-franchising stores, within a specific period of time, in New York City.

### Franchising legal issues

In the US, the franchising regulator is the Federal Trade Commission (FTC), which requires the franchisors to provide potential franchisees with information that will describe the franchisor-franchisee relationship. This information should be present in the two main franchising legal documents, the Franchise Disclosure Document (FDD) and the Franchise Agreement (for detailed information see Exhibit 17). Additionally, when a company submits to "The Department of Law" the FDD, it should also annex a franchise registration filing fee, which, in the New York State, corresponds to \$750 and it is valid for 1 year, subsequently, it is necessary every year to submit a \$150 registration renewal, within 120 days of the close of the franchisor's fiscal year end, and additional documents, such as: Uniform Franchise Registration Application; Supplemental Information; Certification of Application and, Uniform Consent to Service of Process and Guarantee of Performance, with notary public acknowledgment (Office of the Attorney General, 2008).

Therefore, in order to perform all the documents mentioned above and pay the franchise registration fee,  $h_3$  has two options: first, write the contracts and pay the fee itself, and

ask for a company to review the agreements; second, hire a company to do all the necessary contracts and to register the company in the New York State.

First option; write the contracts, pay the fee and hire a firm to review the documents:

Regarding the FDD, since it is a US specific document, the  $h_3$  company should write the document according to the “Franchise Rule – Compliance Guide”<sup>2</sup>, which explains in detail what should be written in the contract, and could see examples of FDDs provided by “The Franchise Openness Project”<sup>3</sup>, for free, and by “Franchise Help”<sup>4</sup>, at a symbolic price, \$199. Additionally, regarding the documents that should also be delivered with the FDD,  $h_3$  could get information about how to write them in the Franchisors & Franchisees area of the Office of the Attorney General website<sup>5</sup>.

Concerning the Franchise Agreement, since  $h_3$  has already started to expand to Madrid through a master franchising agreement, the company has already the necessary know how to write the contract. Thus, the New York’s Franchising Agreement should be very similar to “Grupo VIPS” – Master Franchising Agreement (Exhibit 18). Hence, see Exhibit 19 for detailed information of New York’s Master Franchising Agreement.

Later, the company can hire a franchise law company to review all the documents; one possible option is the W. Michael Garner – Law Offices<sup>6</sup> which would charge a flat fee of \$1.500 and, in return, would review all the contracts, and would provide one-hour consultation to answer to  $h_3$  questions (W. Michael Garner). However,  $h_3$  would also have to go to the New York’s Department of Law to deliver the necessary documents and to pay the franchise registration filing fee.

Second option; hire a franchising law company to write all the necessary contracts:

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<sup>2</sup> <http://business.ftc.gov/sites/default/files/pdf/bus70-franchise-rule-compliance-guide.pdf>

<sup>3</sup> [www.openfran.org](http://www.openfran.org)

<sup>4</sup> [www.franchisehelp.com](http://www.franchisehelp.com)

<sup>5</sup> [www.ag.ny.gov/bureaus/investor\\_protection/franchisors\\_franchises.html](http://www.ag.ny.gov/bureaus/investor_protection/franchisors_franchises.html)

<sup>6</sup> [www.franchisedealerlaw.com](http://www.franchisedealerlaw.com)

Since  $h_3$  has no practice on doing US franchising agreements, it could opt for hiring a franchising law company that would be in charge of doing the FDD, the Franchise Agreement, the other specific contracts and the state registration. One possible company is the W. Michael Garner – Law Offices, which has practiced franchise and distribution law for over thirty years and is regarded as one of the nation's leader trial lawyers and legal writers in the field. Thus, this company would charge a price between \$30.000 and \$50.000 and, in return, it would provide all the necessary documents and it would be in charge of registering the company in the New York State (W. Michael Garner).

### **Expansion of $h_3$ to New York**

To expand to the US market  $h_3$  will have to allocate a worker as a US country manager, who will control and support the master franchisor, and to find a US master franchisor.

In order to find the master franchisor the company could choose to use the help of a franchising consultant company. One possible option is a company named “MatchPoint Franchise Consulting Network”<sup>7</sup> (*MatchPoint*) which is a global franchise consulting network company that has a team of experts who developed “a service unlike any other that uses a simple but powerful test and comprehensive consulting process to match franchise buyers with franchise opportunities. (...) all offerings are underwritten by franchisors who want the right franchisees to join their business”. Therefore,  $h_3$  has to pay an average referral fee of approximately \$12,000 to \$15,000 and, in return, the *MatchPoint* matches the company with a great master franchisor (MatchPoint Franchise Consulting Network, 2010). However, if *MatchPoint* does not find the master franchisor that meets  $h_3$  partners’ expectations, there are some US companies, which are master franchisors of diversified brands, such as Focus Brand, Inc. or Kahala Corp. that could

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<sup>7</sup> [www.matchpointnetwork.com](http://www.matchpointnetwork.com)



possibly be  $h_3$  master franchisors due to their know-how and market experience.

Regarding the master franchisor, it should adapt the concept and bet on street restaurants in either crowded streets or working areas due to the fact that New Yorkers do not have the culture of eating in Shopping malls. In addition, the master franchisor should create take away and home delivery, since it is one of New York's major trends, and both services should be available for request through the  $h_3$  website and by SMS.

However, in order to expand to the US it is important to have a Distribution Centre, thus the US country manager should be in charge of, before opening any store, finding the best suppliers and a Distribution Centre (see Exhibit 20 for possible ones).

### Implementation Plan

After proposing the mode of entry it is important to not only clarify and schedule objectives but also to assign tasks through an implementation plan that will have at most 2 years of duration and should start in January 2014.

In order to define the implementation plan the 4 M's approach (Men, Money, Minute and Memo) was used since it specifies a set of initiatives with an associated timeline, therefore it is the best way to monitor the company's performance.

**Men** –  $h_3$  is going to expand through a franchising agreement, thus the company will neither be in charge of recruiting employees nor to paying them, since this is master franchisor's responsibility. However, since every country has a country manager,  $h_3$  will have to allocate one of  $h_3$  *headquarters'* employees as US country manager.

**Money** – Given that  $h_3$  will have to allocate one of the  $h_3$  *headquarters'* employees as US country manager, he will have a salary increase and will also have to visit New York once in a while. Hence, the  $h_3$  will have costs with the salary increase and the first two travels; the others must be master franchisor's responsibility.

Additionally, the company will have to incur in costs in order to find the right master franchisor, as mentioned previously, the company will have to pay between \$12,000 and \$15,000 to the franchise consulting company *MatchPoint*. Furthermore, in order to perform the necessary agreements,  $h_3$  will also have to pay to a franchise law company. Nonetheless,  $h_3$  could write the contracts and pay \$1,500 to W. Michael Garner – Law Offices to review them, and pay \$750 of New York State registration, or hire the same company to write all the necessary contracts and register the company in the New York State for a price range between \$30,000 and \$50,000.

However, since franchise was the option considered by the company, it will also have the upfront fee as well as the royalties of the master franchisor as revenues.

**Minute** – The following table illustrates when each activity should be performed.

**Table III – Minute – Timeline of each activity**

	Activity	Duration	Dependency
1	Allocation of the country manager	1 month	-
2	Hire “MatchPoint Franchise Consulting Network”	2 – 4 months	Act. 1
3	Chose the right master franchisor	2 – 3 months	Act. 1, 2
4	Hire a franchise law company	2 – 3 months	Act. 3
5	Contract celebration	1 – 2 months	Act. 3, 4
6	Stores design and construction	4 – 6 months	Act. 5
7	Employees training	2 months	Act. 5

(Source: primary data)

**Memo** – The following table exemplifies the company’s main strategies.

**Table IV - Memo**

	Objectives	Measurement	Target	Initiative
<b>Financial</b>	- Raise sales’ revenue - Increase the number of stores	- Sales revenue - Sales volume - Fees per store - Royalties	- Cover the 1 <sup>st</sup> year costs - Increase 50% of sales, at the end of the 2 <sup>nd</sup> year	- Creation of Master Franchisor partnerships
<b>Customer</b>	- Create company’s brand awareness in NY	- Market Research - Nr. of visitors, annually	- Increase brand awareness in 50%	- Marketing campaigns - Webpage with information

Internal	- Translate the manuals - Train the NY's team	- Evaluation according to the company's objectives	- Have all the team trained within 2 months	- Translation of manuals - Train workers
Learning	- Anticipate customers needs and create solutions that answer to their demands	- Customer satisfaction	- Order's increase	- Creation of new menus that fulfill the New Yorkers specific needs

(Source: primary data)

## Conclusions

After analysing the  $h_3$  company, the Portuguese, the US and the New York fast food markets, the conclusion is that  $h_3$  should only expand to the New York City in 2014. This can be explained by the fact that the New York fast food market is enormous and very competitive, additionally, at the present time, the fast food market is not very attractive, due to lower growth rates, thus, in order to compete with the existing restaurants it should first increase its global brand awareness by opening more stores in Brazil and Europe and, only after that, expand to New York.

Regarding the internationalization to New York, the company should use a Master Franchising Agreement since it leads to company's rapid expansion, brand recognition and consistency in delivering the promised brand at a low costs for  $h_3$  as the master franchisor has the majority of the costs.

Furthermore, in my opinion, to open a store in New York the company will have to adapt its positioning because there are few Shopping centres with food courts and people do not have the habit of eating on a Shopping; instead people prefer to eat on streets. Hence,  $h_3$  should position on crowded streets or in working areas, such as, around the 5<sup>th</sup> Avenue or in the Financial District.

To conclude, once the restaurant is open it will be a huge success by the fact that in New York gourmet hamburgers are considered premium meals and these do not exist as fast food. Thus,  $h_3$  could take advantage of this opportunity.

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### Exhibit 1 – Branding of the $h_3$ restaurants

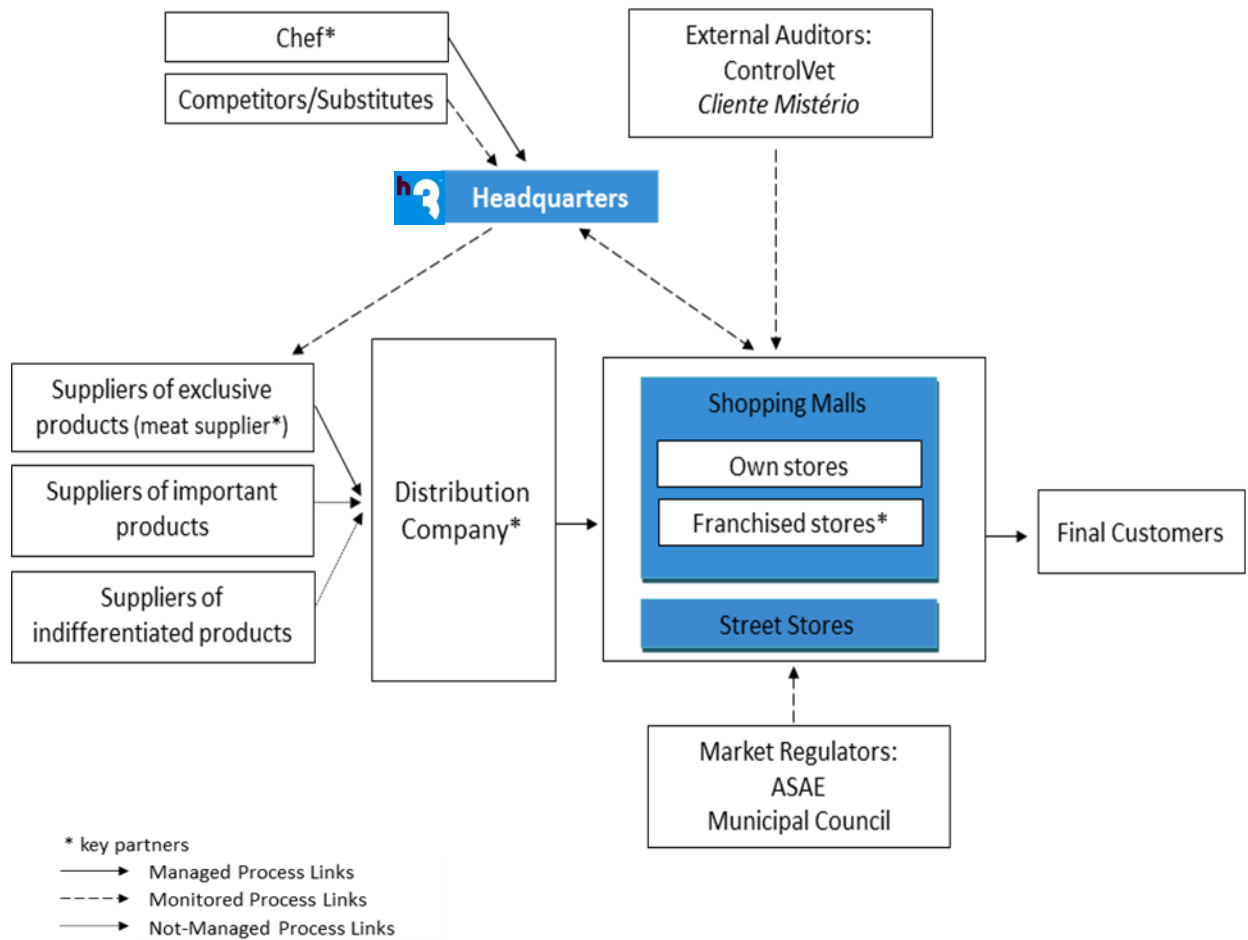
The three partners decided to name the restaurant by  $h_3$  due to the fact that the restaurant would only offer hamburgers and they were three partners. Additionally, they chose white, blue and bourdeaux, as the main colours of the restaurant, due to the fact that these were colours that did not exist in the shopping centres' food courts, therefore the colours would contrast from the other restaurants and would attract the customers attention.

### Exhibit 2 – $h_3$ 's organizational structure



(Source:  $h_3$ , 2011)

### Exhibit 3 – Industry Mapping



(Source: primary data)

**Managed Process Links** - links that are managed by the focal company

**Monitored Process Links** - links that are not critical to the focal company but they are important to be integrated in the supply chain

**Not-Managed Process Links** - links that the focal company delegates totally

### Exhibit 4 – Indirect suppliers of $h_3$

The indirect suppliers are characterized according to the products that they provide. In detail,  $h_3$  characterizes the products as *Exclusive*, *Important* and *Undifferentiated*.

Regarding the *Exclusive* products, these can only be supplied by companies that were previously decided by  $h_3$ ; as a result, the Centre of Distribution is obliged, by contract,

to purchase these types of products to a specific supplier. An example is the hamburger's meat, which should only be provided by one of the key partners, the meat supplier. Concerning the *Important* products, the Centre of Distribution can choose the supplier as long as the products have quality and pursue the specific characteristics ordered by  $h_3$ . The potato is an example of product that must have specific characteristics; however the Centre of Distribution is in charge of choosing a supplier with the proper quality. Finally, the *Undifferentiated* products, correspond to products such as, salt, pepper or sugar, that can be provided by any supplier and do not have to follow a specific characteristic.

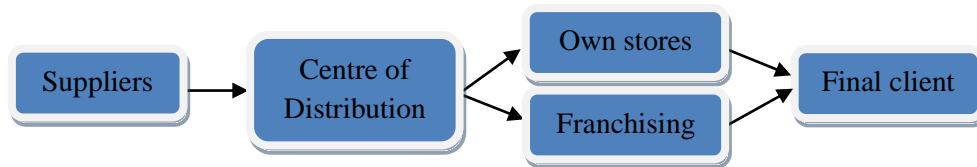
#### **Exhibit 5 – Foreign stores' suppliers**

The Warsaw and São Paulo's stores, now both have their own suppliers since it is less expensive than importing the products from Portugal. However, it was not always like this, at the beginning, the Warsaw's store imported all the products from the Portuguese Centre of Distribution because the store's partners (the three  $h_3$  partners and another three partners, two Portuguese and one Polish) thought that importing the products from Portugal would lead to products' price reduction due to economies scale which would outweigh the transportation costs. Conversely, over the time, the partners acquired market knowledge and understood that having their own Warsaw suppliers was more profitable. Therefore, concerning the São Paulo's store, since the  $h_3$  partners experienced the supplier changes related to the Warsaw's store, they decided to go to São Paulo before opening the stores in order to find the suppliers and the conditions that they were looking for.

Regarding the Madrid store, its supplier is the Portuguese Centre of Distribution;

however, in order to reduce costs, there is another company that is in charge of transporting the products from Portugal to Madrid.

#### **Exhibit 6 – $h_3$ production chain**



(Source:  $h_3$ )

#### **Exhibit 7 – $h_3$ Quality Department**

Before any product starts to be sold on a store, the  $h_3$  Quality Department is in charge of approving the manufacturer, the production method and the final product. Consequently, the product only starts to be sold, on a restaurant, after it has been approved by  $h_3$  Quality Department.

#### **Exhibit 8 – Online and food court survey to $h_3$ consumers**

During November both my group and I performed an online and food court survey to 368  $h_3$  consumers in order to understand: the major competitors of the company, if people go to Shopping centres just to eat an  $h_3$  meal and where do usually people have lunch.

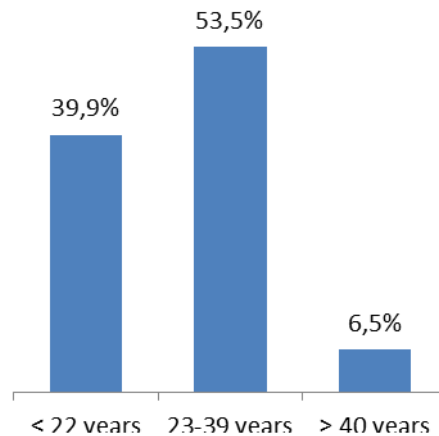
However, it is important to take into consideration that this survey has some limitations; to start, the food court surveys were only performed in Lisbon, to people that were waiting on the  $h_3$  queue, thus there is a great chance that their answers were influenced by the surrounding restaurants. Additionally, there is also a great probability that the people who answered to the online survey were our friends, since my group and I sent the survey's link to friends; therefore, there is a high likelihood that the majority of



people who answered the survey were people from Lisbon with a relatively low age range. As a result, the sample could not be a representative sample.

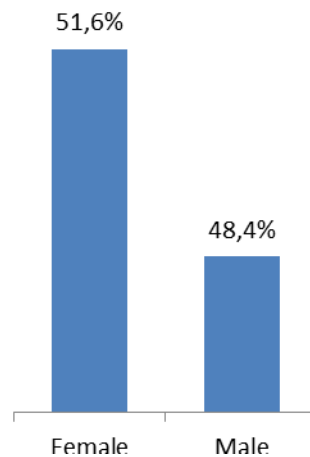
In addition, the surveys focused on the lunching time, during the week. Therefore, it is important to take into consideration the possibility of existing biases.

**Exhibit 8 1 – Age of the  $h_3$  consumers who answered the survey**



(Source: Survey research, 2011)

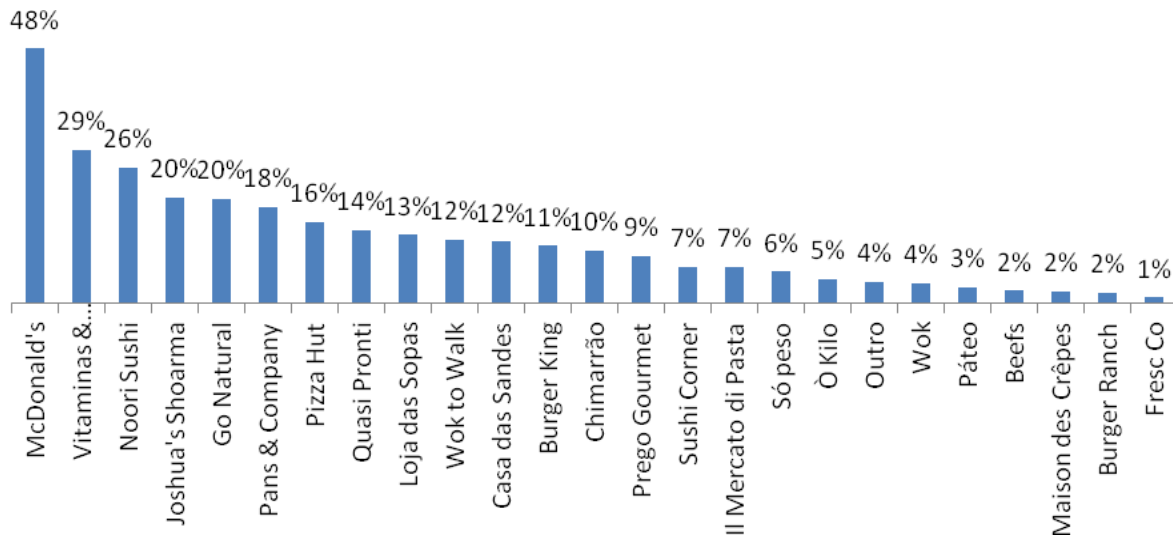
**Exhibit 8 2 - Gender of the  $h_3$  consumers who answered the survey**



(Source: Survey research, 2011)

**Exhibit 8 3 -  $h_3$  main competitors, according to the people that answered the survey**

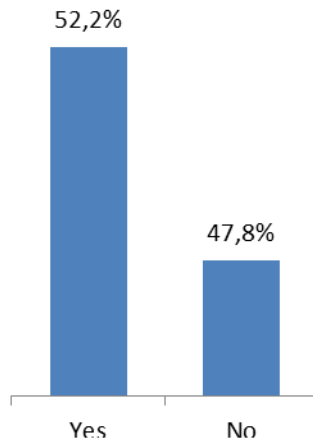
**“Where would you have lunch if there was no  $h_3$  restaurant?”**



(Source: Survey research, 2011)

**Exhibit 8 4 – Percentage of  $h_3$  consumers who purposely go to a Shopping centre to eat an  $h_3$  meal**

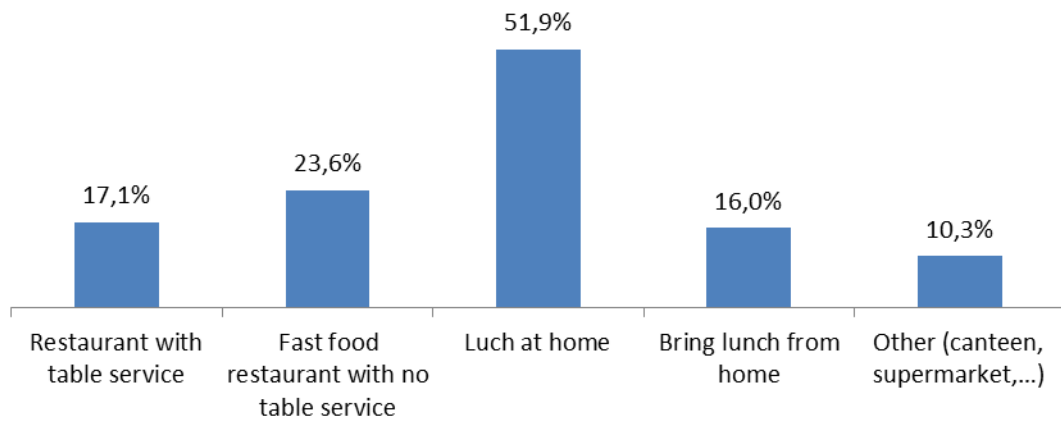
**“Would you go to a Shopping Centre just to eat an  $h_3$  meal?”**



(Source: Survey research, 2011)

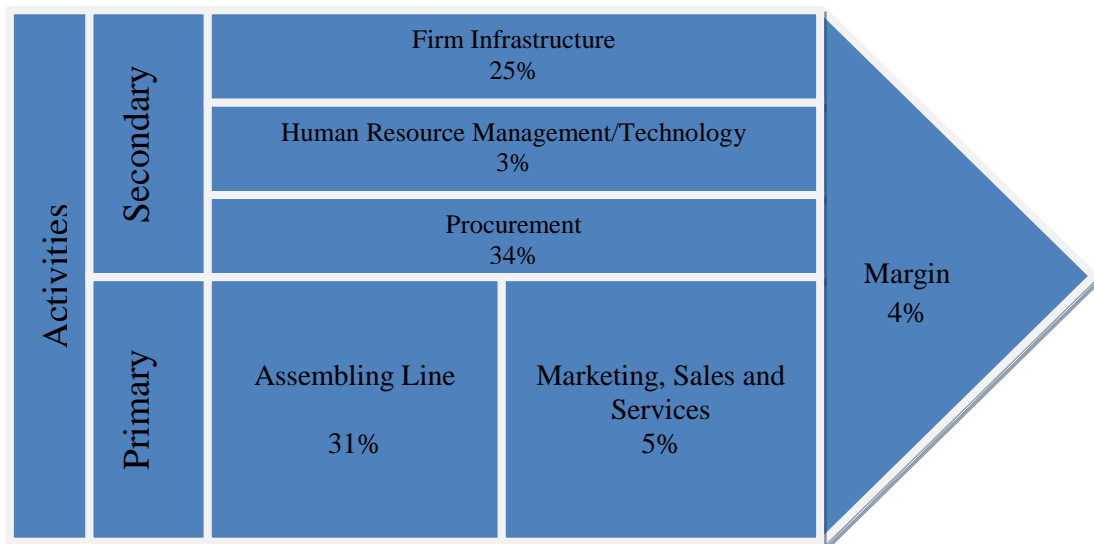
**Exhibit 8 5 – Places where the majority of  $h_3$  consumers, who answered the survey, have lunch**

**“During the week, where do you usually have lunch?”**



(Source: Survey research, 2011)

### Exhibit 9 – Own stores Value Chain



(Source: primary data)

### Exhibit 10 – Factors that are essential for the company's sustainability

Some factors that are essential for the company's sustainability are the following:

- Strong brand recognition – Regarding  $h_3$ , it developed a credible and well-recognized brand; therefore, the company has easier access to the distribution channels, mainly Shopping Centres.

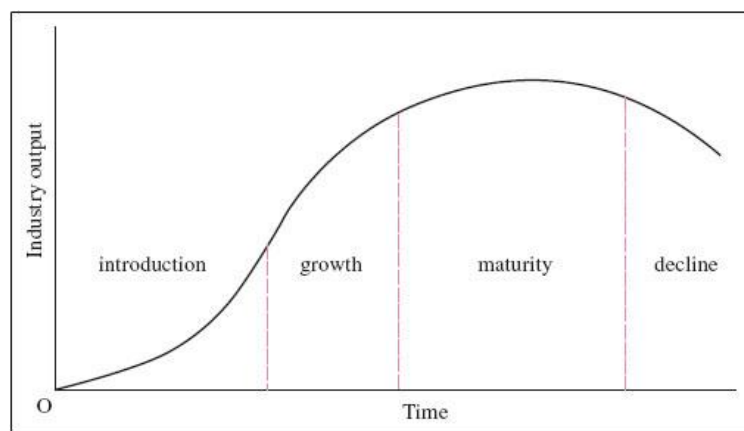
- Key partners – Concerning the  $h_3$ 's key partners (the *Chef*, the franchises, the meat supplier and the Distribution Centre), they are considered as an essential factor for the company's sustainability due to the fact that they have a great role on the company's expansion.
- Process standardization - Was implemented, by  $h_3$ , with creative manuals produced by the partners. These lead to a cost and time efficient company and also facilitated the worker's adaptation to the production processes.
- Market know-how – Finally, the know-how that the three partners have of the market, due to their previous experience in *Café 3*, is something that helps on the company's sustainability.

**Exhibit 11 –  $h_3$  market shares**

Market \ Year	2007	2008	2009	2010
$h_3$ in Fast Food	1.3%	1.5%	2.8%	4.9%
$h_3$ in Consumer Foodservice	0.8%	1.0%	1.8%	3.2%

(Source: Euromonitor International, 2011)

**Exhibit 12 - Industry Life Cycle**



(Source: Henry, Anthony. 2008. *Understanding Strategic Management*)

**Introduction stage** – This stage is characterized by having slow growth on sales and high costs due to the limited production, which can be explained by the low demand. Additionally, at this stage, there will be little or no competition and profits will be negative since sales will be insufficient to cover the investment and production costs.

**Growth stage** – At this stage, sales increase rapidly as market grows, allowing firms to take advantage of economies of scale. Therefore, this stage is characterized by having greater profits; due to this reason, new entrants will be attracted to the market, which may lead to price decreases.

**Maturity stage** – During this stage, both sales growth and profits start to slow due to market saturation. Thus, some firms will begin to exit the industry and others will increase the low-cost competition (Ex: “Euro Poupança” campaign, launched by McDonalds, which offers several products at 1€ each), as a result, competition will be intensified.

Regarding the fast food industry, now it is at the mature stage (Roman Zwolak, 2010).

**Decline Stage** – The last stage is characterized by having a decrease on sales and profitability, due to customers shift to new products (Anthony Henry, 2008).

### **Exhibit 13 – Indirect suppliers bargaining power**

The indirect suppliers, which provide products to the Distribution Centre, have low bargaining power because they are quite dependent of  $h_3$  due to the enormous volume of products purchased by the company.

The only indirect supplier that has medium bargaining power is the meat supplier since it provides an *Exclusive* product and, to accompany the company’s expansion, it opened

a new factory that produces hamburgers only to  $h_3$ ; therefore, the meat supplier is relatively dependent on the volumes of meat purchased by  $h_3$  and, if, for some reason,  $h_3$  terminates the contract, the meat supplier stays with the factory however, in a short period of time, he will not be able to sell the hamburgers because he does not have any other client; regarding  $h_3$ , the company will be provided by another meat supplier with which it has already a second contract, however, there will be extra costs and it will take time to change, therefore there will be switching costs. As a result, the meat supplier has medium bargaining power.

#### Exhibit 14 - SWOT Analysis

1. Strengths	2. Weaknesses
<ol style="list-style-type: none"> <li>1. Single product (hamburger) which leads to a standardization process that is cost and time effective</li> <li>2. Fresh and quality ingredients</li> <li>3. Corporate team structure which allows good communication flow due to the friendship of <math>h_3</math>'s partners</li> <li>4. Excellent branding and creativity</li> <li>5. Well-defined training program for employees</li> <li>6. Key partners (Chef, meat supplier, Centre of Distribution and Franchisees)</li> <li>7. Good price/quality relationship</li> <li>8. <i>New Hamburgology</i> and <i>Not so fast food</i>, two trademarks registered in WIPO</li> <li>9. Superior position in the Learning Curve which makes the concept difficult to copy</li> <li>10. Possibility of personalize the meal</li> </ol>	<ol style="list-style-type: none"> <li>1. No variety of meat type which leads to similar menus</li> <li>2. <math>h_3</math>'s Shopping environment</li> <li>3. The partners are really close to each other, consequently, sometimes they do not formalize all the company tactics and strategies</li> <li>4. Lack of Market Research</li> </ol>
Opportunities	Threats
<ol style="list-style-type: none"> <li>1. Shopping centres' increase in Portugal</li> </ol>	<ol style="list-style-type: none"> <li>1. Mature stage of the fast food market</li> </ol>

2. Increase of fast food consumption	and significant variety of restaurants
3. Trend towards selecting healthy food	2. Trend towards “ <i>food to go</i> ” or “ <i>take away</i> ” around Europe and Portugal
4. Economic Crisis, which leads to cheaper meals, therefore people change from restaurants with table service to fast food restaurants	3. Potential cow disease – epidemics
5. Increase of the franchising model in the fast food industry	4. Main competitors are well-expanded international companies
	5. Main competitors offer a wider variety of menus and additional products
	6. Restoration’s VAT increased to 23%
	7. Economic Crisis, since people do not have money they tend to eat more at home or bring more meals from home

(Source: primary data)

### Exhibit 15 - World Fast Food Market Analysis

“The global *Fast Food* market has been decelerating in recent years as a result of the worldwide economic malaise” (Datamonitor, 2010b: 8). Therefore, in 2009, the global fast food market grew by 3.1% and had a total revenue of \$201.1 billion, representing a compound annual growth rate (CAGR) of 4.8%, for the period between 2005 and 2009. For the upcoming years, the performance of the market is forecasted to continue to decelerate, nonetheless, in 2014, the global *Fast Food* market is forecasted to increase 19.3%, since 2009, reaching total revenue of \$239.8 billion and a CAGR of 3.6% in the period 2009-2014.

Concerning the market consumption volumes, in 2009, the global *Fast Food* market grew by 3.9%, reaching a volume of 208.1 billion of transactions. This volume of transactions is forecasted to increase by 19.5%, since 2009, and reach a volume of 248.7 billion transactions, in 2014. The CAGR in the period 2005-2009 was 4.6% and in the period 2009-2014 is expected to be 3.6%.

Additionally, the QSR segment was the most lucrative segment of the market, in 2009, with total revenue of \$142.6 billion, which is equivalent to 70.9% of the market's total value. Concerning the Takeaways, the Mobile & Street Vendors and the Leisure Locations, they accounted for 12.1%, 11.2% and 5.8% of the market's overall value, respectively.

Finally, the Americas market (47.4%) was the largest segment of the global *Fast Food* market, following by the Asia-Pacific market (35.6%) and the Europe market (17.0%) (Datamonitor, 2010).

### **Exhibit 16 – Franchising**

Franchise corresponds to an agreement between two legally independent parties, the franchisor and the franchisee, which gives the right to the franchisee to market a product or service using the trademark and/or the operating method of the franchisor. In return, the franchisee usually has the obligation to pay a one-time franchisee fee plus a percentage of sales revenue as royalties. Therefore, expanding through franchising will lead to company's rapid expansion, brand recognition and consistency, in delivering the promised brand.

Regarding franchise, there are two types of franchises, the product distribution franchises and the business format franchises. The former type of franchise simply sells the franchisor's products; an example is the Ford Motor Company. The latter usually uses the franchisor's product, service and trademark, as well as, the complete method of conducting the business itself, such as the marketing plan and the operations manuals. This type of franchise is the most common and it is mainly used in industries such as



Fast Food, Service, Maintenance and others; some examples of business format franchises are McDonalds and Starbucks.

Additionally, regarding franchising there are also two types of ownership structure, the single-unit franchise and the multi-unit franchise. The first type, single-unit franchise, is an agreement where the franchisor grants the franchisee the right to open and operate only one franchise unit. The second type, the multi-unit franchise, it is subdivided into area development franchise and master franchise. Regarding the area development franchise, it has the right to open more than one unit during a specific time, within a specific area and, in return, the franchisor grants the franchisee exclusive rights for the development of that territory. Concerning the master franchise, it also has the right to open and operate a certain number of units, during a specific time in a defined area, and, additionally, it has the right to sell franchises to other people within that territory, in order to create the so-called sub-franchises. As a result, the master franchisee will also assume tasks, responsibilities and benefits of the franchisor (International Franchise Association).

#### **Exhibit 17 – Franchising legal issues**

**Franchise Disclosure Document** – This document is provided by the franchisor to the potential franchisee, at least 14 calendar days before the signature of the contract, and, its main purpose is to present information about the franchisor, the franchise system and the agreements, in order to the potential franchise make an informed decision about investing, or not, in that particular franchise.

More precisely, the FDD should include the following franchisor's information: company's characteristics, key staff, bankruptcy and litigation history, contact

information of other franchisees (within the same system) and company's management experience in franchise management. Additionally, regarding the franchisee, the document should also contain the required investment and purchases as well as the initial and on-going fees involved in opening and running the franchise and the territory rights. Finally, the FDD should also include both franchisor and franchisee responsibilities (International Franchise Association).

**Franchise Agreement** – This document is more specific than the FDD since it corresponds to the legal document that binds the franchisor and franchisee together. As a result, the Franchise Agreement should include information about the applied franchise system, such as trademarks and operating methods and it should also include rights and obligations of each one of the parties. Additionally, it should contain the payment terms, the duration, the operation territory and the termination conditions of the franchisee. And, to conclude, the document should mention the training, assistance and advertising conditions (International Franchise Association).

#### **Exhibit 18 - “Grupo VIPS” - Master Franchising Agreement**

“Grupo VIPS” (abbreviated to “*VIPS*”), is the  $h_3$ 's master franchisor in Spain and Andorra; therefore, it has the exclusive right of using the  $h_3$ 's brand in Spain and Andorra, during the following 20 years, and it is also in charge of opening 10 stores until the end of 2012. Additionally, since *VIPS* is a master franchisor, it should also sell sub-franchises, within the territory that it is in charge; however, only 40% of the stores can be sub-franchised and the other 60% should belong to *VIPS*.

Regarding payments, to start, *VIPS* has to pay an up-front fee that allows it to use the company's brand and image and another fee for every store that the group opens.

Additionally, *VIPS* has to pay royalties, between 5% and 10%, that depend on each restaurant's monthly gross sales; therefore, the greater the sales the greater will be the royalty paid. This royalty corresponds to the unique variable parameter of the contract because it depends on monthly gross sales and on the contract's negotiation; as a result, this royalty varies from one contract to another.

Concerning the Spain's menu price, which will define the company's strategic position, *VIPS* has the right to suggest a price, since it already knows the market; however, the *h<sub>3</sub> headquarters* have to approve it.

Additionally, the contract also states the main procedures that *VIPS* has to perform when opening the first two stores, in Spain. More precisely, regarding the stores layout, both the Portuguese *h<sub>3</sub>*'s team of architects and art director are in charge of designing the first two stores in order to form a Spanish team of architects that would be in charge of doing the layout of the following stores. Additionally, the contract also states that the marketing campaigns, of the first two stores, should be exclusively developed by the *h<sub>3</sub> headquarters*, however *VIPS* should pay both. Subsequently, the group is in charge of having the initiative to present, at least two marketing campaigns per year, which will have to be approved by the *h<sub>3</sub> headquarters*.

Furthermore, the contract also guarantees the employees' training of the first two stores, in Portugal; however, from the opening of the third store onwards, the employees are trained by *VIPS*, in Spain. This measure is already considering a global strategy, because if *h<sub>3</sub>* expands to another country and if that country is closer to Spain, then the new employees can be trained in Spain, instead of Portugal, which will allow to cost reduction.

To conclude, each country's master franchisor will have access to all the  $h_3$ 's operating manuals and will have an exclusively country manager who will provide ongoing support.

### **Exhibit 19 – New York's Master Franchising Agreement**

The New York's master franchisor should have the exclusive right of using the  $h_3$ 's brand in the whole New York State, during 20 consecutive years, and it should also be in charge of opening an agreed number of stores during the first year. Additionally, the master franchisor should also sell sub-franchises, within the New York State; however, only 40% of the stores can be sub-franchised, and the other 60% should belong to the master franchisor.

Regarding the payments, New York's master franchisor should pay an up-front fee that allows it to use the company's brand and image and another fee for every store that it opens. Additionally, it should pay royalties, which correspond to the unique variable parameter of the contract because they depend on monthly gross sales and on the contract's negotiation. Ideally, these royalties should vary between 5% and 10%, the greater the sales the greater will be the royalties paid.

Concerning the New York's menu price, which will define the company's strategic position, the master franchisor should suggest a price, since it already knows the market; however, the  $h_3$  *headquarters* have to approve it.

Additionally, the contract states the main procedures that the New York's master franchisor should perform when opening the first two stores. More precisely, regarding the stores layout, both the Portuguese  $h_3$ 's team of architects and art director are in charge of designing these stores in order to train a New Yorkers team of architects that

would be in charge of doing the layout of the following stores. Furthermore, the contract also states that the marketing campaigns, of the first two stores, should be exclusively developed by the  $h_3$  headquarters; however the master franchisor should pay both. Subsequently, the master franchisor is in charge of having the initiative to present, at least two marketing campaigns per year, which will have to be approved by the  $h_3$  headquarters.

Furthermore, the contract guarantees the employees' training of the first two stores, in Portugal; however, from the opening of the third store onwards, the employees are trained by the master franchisor, in New York. This measure is already considering a global strategy, because if  $h_3$  expands to another US state, then the new employees should be trained in New York, instead of Portugal, which will allow to cost reduction.

To finish, the New Yorker's master franchisor will have access to all the  $h_3$ 's operating manuals and will have an exclusively manager who will provide ongoing support.

#### **Exhibit 20 – Possible $h_3$ Distribution Centres in the US**

One possible Distribution Centre of  $h_3$  in the US is a company, named “Maines Paper & Food”, which is one of the leading foodservice distributors in the US. This company provides fresh products, dry goods as well as a variety of non-food items to restaurants in more than thirty-five states through ten distribution centres.

Moreover, regarding its vision, “Maines Paper & Food” wants “to be the first-choice provider of quality foodservice products and services”, therefore, since one of the major concerns of the company is products' quality, it shares the  $h_3$ 's values and, consequently, it could be a possible  $h_3$  US Centre of Distribution (Inc. Mains Paper & Food Service).

Another possible Distribution Centre is a company named “Golden State Foods Corporation”, which is one of the largest diversified suppliers in the foodservice and QSR industry by offering raw materials, equipment sourcing, procurement, food processing/manufacturing, custom distribution and convenient on-site services. Therefore, due to the wide variety of products and services provided, this company could also be  $h_3$  US Centre of Distribution (Golden State Foods).

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